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IN THE

Supreme Court of the United States

STONERIDGE INVESTMENT PARTNERS, LLC,
Petitioner,

v.

SCIENTIFIC-ATLANTA, INC. and MOTOROLA, INC.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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BRIEF OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTEREST OF THE *AMICUS CURIAE*

The North American Securities Administrators Association, Inc. ("NASAA"), is the nonprofit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. It has 67 members, including the securities regulators in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Formed in 1919, it is the oldest international organization devoted to protecting investors from fraud and abuse in connection with the offer and sale of securities.[1]

[1] Pursuant to SUP. CT. R. 37.6, NASAA represents that no counsel for any party authored this brief in whole or in part, and no person or entity, other than NASAA, its members, or its counsel, made any monetary con-

The U.S. members of NASAA are responsible for administering state securities laws and regulations. Their activities include licensing broker-dealers, registering local securities offerings, and conducting compliance examinations. Especially important is their enforcement role: protecting the nation's investors by bringing literally thousands of enforcement actions every year against the firms and individuals who have committed fraud and abuse in connection with the sale of securities. In those cases, state securities regulators often seek restitution to help make injured investors whole, although the best hope of recovery for the vast majority of defrauded investors is through the courts in private actions for damages, not through governmental enforcement actions at either the state or federal level.

NASAA supports the work of its members through training programs, enforcement assistance, and legislative analysis. Another important role of the association is representing the membership's position as *amicus curiae* in significant cases brought by private plaintiffs as well as government regulators involving the interpretation of the securities laws and the rights of investors. *See, e.g.*, Brief of the North American Securities Administrators Association, Inc., as *Amicus Curiae*, in Support of Respondents, filed in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, Case No. 06-484 (U.S. Mar. 9, 2007) (supporting investors' position on the "strong inference of scienter" standard under the Private Securities Litigation Reform Act), *available at* http://www.nasaa.org/content/Files/Tellabs.pdf; Brief of *Amicus Curiae* North American Securities Administrators Association, Inc., in Support of the People of the State of California, filed in *People v. Edward D.*

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tribution to the preparation or submission of the brief. Pursuant to SUP. CT. R. 37.3, NASAA further represents that all parties to this appeal have consented to the filing of this *amicus* brief. The Petitioner's written consent is on file with the Court, and the Respondents' written consent accompanies this brief.

Jones & Co., Case No. CO53407 (Cal. Ct. App. Feb. 23, 2007), *available at* http://www.nasaa.org/content/Files/ED_JONES_FINAL.pdf.

NASAA and its members have an interest in the outcome of this appeal because it will profoundly affect the ability of investors to seek redress in cases where unscrupulous companies and individuals have actively participated with issuers in schemes to defraud the securities markets. The Eighth Circuit incorrectly held that any defendant who does not make a fraudulent misstatement or omission, or who does not engage in manipulative trading of securities, cannot be held liable as a primary violator of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5. The lower court adopted the narrow view that absent those specific forms of misconduct, a defendant is at most an aider and abettor immune from suit under *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994). If this Court affirms the lower court and thus insulates a broad range of deceptive practices from the reach of Section 10(b), many victims of securities fraud with meritorious claims will lose the opportunity to recover damages resulting from undeniably culpable behavior. As advocates for the rights of investors to seek redress, NASAA and its members have an interest in supporting reversal and restoring an interpretation of the law that is more in keeping with its language, intent, and underlying purposes.

This Court's decision will also have a pivotal effect on the role of private actions as a deterrent against securities fraud. Private actions by defrauded investors are an enormously important complement to regulatory enforcement actions as a means of policing the securities marketplace. State and federal securities regulators work tirelessly to detect, enjoin, and punish financial fraud. However, private actions not only provide the principal means of compensation for victims of

securities fraud, they also play a vitally important role in protecting the integrity of the marketplace through deterrence, a fact often noted by this Court. *See, e.g., Basic Inc. v. Levinson*, 485 U.S. 224, 230-31 (1988) (the private cause of action for violations of Section 10(b) and Rule 10b-5 constitutes an "essential tool for enforcement of the 1934 Act's requirements"). The burgeoning growth in large-scale securities fraud over the past decade shows that a broad interpretation of Section 10(b), in keeping with its remedial purposes, is just as important today as it was in 1934, perhaps more so. To the extent that the Court erects unwarranted barriers to recovery in private actions—such as immunity for those who participate in fraudulent schemes through deceptive acts, not words—the Court will undermine an important deterrent that benefits the marketplace as a whole. For this additional reason, NASAA and its members support reversal of the circuit court's decision.

SUMMARY OF THE ARGUMENT

The lower court erred when it dismissed the Petitioner's claims and held that Section 10(b) of the Exchange Act and Rule 10b-5 encompass only misstatements and omissions of material fact and not deceptive acts performed as part of a scheme to defraud the securities markets. The lower court's narrow construction conflicts with the plain language of the statute, Congress's intent that the antifraud provisions of the Exchange Act be construed broadly, and this Court's decisions recognizing that Section 10(b) applies to deceptive actions as well as misstatements and omissions.

The lower court also erred by ignoring the public policy implications of its interpretation of the law. The boundless ingenuity of those who commit fraud and the need to protect investors from fraud and abuse together make it imperative that Section 10(b) be applied to all types of deceptive devices. A decision that holds all parties accountable for their role in a

fraudulent scheme—regardless of whether their deception was perpetrated through words or deeds—will help repair the damage done to investors and deter future violations, without unduly burdening the legitimate industry. At a time when large scale financial fraud shows little sign of abating, this Court should ensure that injured investors have the opportunity to seek relief in federal court. For these reasons, the Court should reverse the lower court's decision and reinstate the Petitioner's claims.

ARGUMENT

I. THE RESPONDENTS CAN BE HELD PRIMARILY LIABLE UNDER SECTION 10(B) BECAUSE THE SHAM BUSINESS TRANSACTIONS THEY ENTERED INTO WERE "DECEPTIVE DEVICES" WITHIN THE MEANING OF THE STATUTE; SECTION 10(B) WAS WRITTEN TO ADDRESS DECEPTIVE CONDUCT AS WELL AS MISREPRESENTATIONS AND OMISSIONS OF MATERIAL FACT

Section 10(b) of the Exchange Act applies to the deceptive business transactions that the Respondents entered into with Charter Communications, Inc. ("Charter") to perpetrate a fraud on the securities market. The lower court held to the contrary and dismissed the Petitioner's claims, ruling that "[a] device or contrivance is not 'deceptive,' within the meaning of § 10(b), absent some misstatement or a failure to disclose by one who has a duty to disclose." *In re Charter Communications, Inc., Sec. Litig.*, 443 F. 3d 987, 992 (8th Cir. 2006), *cert. granted*, 127 S. Ct. 1873 (Mar. 26, 2007).

The lower court erred. The plain language of the statute, its legislative history, and the decisions of this Court all show that Section 10(b) encompasses deceptive conduct as well as misstatements and omissions. Moreover, Section 10(b)

applies to *any* person that has used a deceptive device to perpetrate a fraud, regardless of whether that person is a corporate insider, an accountant, or simply an outside business partner. In this case, the Respondents participated in sham business transactions that had no economic purpose other than artificially inflating Charter's revenues and its stock price. Even if the Respondents did not publicly disseminate false statements reflecting those transactions, their deceptive conduct led to the same result—a fraud on the market. By virtue of these acts, the Respondents used "deceptive devices" within the meaning of Section 10(b). Accordingly, they should be held accountable as primary violators in a trial on the merits.

A. The Plain Words of Section 10(b) Encompass Deceptive Acts, Not Only Misrepresentations and Omissions

The lower court's narrow interpretation of Section 10(b) is not consistent with the plain language of the Exchange Act. The primary guide to the meaning of any statute is the language of the statute itself. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring). This Court evaluates both the literal meaning of the words used in a statute, as well as their connotation, to ascertain Congress's intent. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 & n.20 (1976) (relying upon definitions and connotations of the words "device," "contrivance," and "manipulate" as the basis for its holding that Section 10(b) requires some degree of scienter). In this case, the wording of Section 10(b) plainly covers a broad spectrum of conduct in addition to misrepresentations and omissions. Congress made it unlawful for "any person, directly or indirectly, . . . to use or employ, . . . any *manipulative or deceptive device or contrivance*" in contravention of the SEC's rules and regulations. 15 U.S.C. § 78j(b) (emphasis added). The words "use," "employ," "device," and "contrivance" all have inher-

ently nonverbal definitions and connotations. *Cf. Ernst & Ernst*, 425 U.S. at 199 n.20. Further, the word "deceive" "implies deliberate misrepresentation of facts" by "actions" as well as "words." *See* WEBSTER'S NEW WORLD DICTIONARY (3rd ed. 1986). Congress's repeated use of the word "any" is another clear indication that the provision was intended to be broad and "inclusive." *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972). Congress had no intention of limiting its comprehensive ban on fraud in Section 10(b) to strictly verbal utterances.

Congress's choice of more limited wording in other anti-fraud provisions of the securities laws underscores the intended breadth of Section 10(b). *Cf. Ernst & Ernst v. Hochfelder*, 425 U.S. at 206 (observing that the 1933 and 1934 Acts are interrelated components of a federal regulatory scheme, and comparing various provisions to ascertain Congressional intent with respect to scienter). For example, in Section 12(a)(2) of the Securities Act of 1933, Congress established civil liability for very a carefully defined type of fraud. The provision targets the offer or sale of a security "by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances in which they were made, not misleading . . ." 15 U.S.C. § 77*l*(a)(2). Obviously, Congress knew how to target misrepresentations and omissions alone when it wanted to do so, and it is appropriate to infer that Congress intended something distinctive and broader in Section 10(b).

The legal context in which Congress drafted Section 10(b) also supports imposition of liability upon all those who participate in a fraudulent scheme through actions or words. The Exchange Act was intended not only to preserve all rights and remedies under the common law, but to strengthen those standards of conduct. *See* 15 U.S.C. § 78bb(a) (rights

and remedies provided under statute are in addition to "any and all other rights and remedies that may exist at law or in equity"); *Basic Inc. v. Levinson*, 485 U.S. 224, 244 n.22 (1988) (Rule 10b-5 actions were intended "to add to protections provided investors under the common law"); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 388 (1983) ("important purpose of the federal securities acts was to rectify perceived deficiencies in the available common law remedies by establishing higher standards of conduct in the securities industry"). One of the attributes of the common law in 1934 was liability for those who participated in a fraud. *See* Robert A. Prentice, *Locating that "Indistinct" and "Virtually Non-existent" Line Between Primary and Secondary Liability Under Section 10(b)*, 75 N.C. L. Rev. 691, 753 (1997), and cases cited therein at nn.266 & 267 (the common law was very clear in holding that all participants in a fraudulent scheme—not just those who had direct contact with the victim—were liable to the scheme's victims). Given the Congressional desire to improve upon available remedies, Section 10(b) deserves an interpretation at least as broad as the common law doctrines prevailing at the time of enactment. By this measure, all participants in a fraudulent scheme who engage in deception can be held primarily liable.

Although the Court in *Central Bank* rejected a similar analysis as to aiding and abetting liability under Section 10(b), it did so because largely because it questioned whether aiding and abetting was really part of the common law. *See Central Bank*, 511 U.S. at 181-82. The Court did not, however, reject the general principle that, absent direct conflict with statutory language, the jurisprudence of Section 10(b) should be informed by the common law. *Cf. SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963) (broad interpretation of the antifraud provisions in the Investment Advisers Act is supported by an evolution in the common law of fraud to encompass breach of fiduciary duty in securities transactions). In this case, there is no uncertainty

that the common law of fraud historically attached primary liability to all of the participants in a fraudulent scheme.

B. The Legislative History of the Exchange Act Makes Clear that Congress Intended Section 10(b) as a Flexible, Catchall Provision, to Be Applied to a Wide Variety of Fraudulent Schemes

The legislative history of the Exchange Act, although not extensive with respect to Section 10(b), supports a broad reading of the provision, one that covers a wide range of manipulative and deceptive conduct. The legislative reports describe the purpose of the law in terms of prohibiting "inequitable and unfair *practices*." *See, e.g.*, S. REP. NO. 73-792 (1934), 1934 WL 1289, at *1, *6 (also explaining that statute was aimed at "manipulative and deceptive practices"). Nowhere in the legislative history is there any language stating or suggesting that Section 10(b) was intended to cover only misstatements and omissions. Under this Court's decisions interpreting Section 10(b), the absence of such legislative history is a significant reflection of Congress's intent. *See Ernst & Ernst*, 425 U.S. at 202 (noting the absence of any legislative history supporting a negligence standard).

The legislative history also reveals that Congress intended Section 10(b) to be a "catchall" provision that would give the SEC authority to deal with "new manipulative devices." *See Ernst & Ernst*, 425 U.S. at 202 (quoting testimony); *see also* H. REP. NO. 73-1383 (1934), 1934 WL 1290, at *6-7 ("In a field where practices constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means, broad administrative powers in the administrative agency have been found practically essential . . . ."). This Court's decisions reflect the same point: interpretations of the securities laws must be "capable of adaptation to meet the countless and variable schemes devised by

those who seek the use of the money of others on the promise of profits." *See SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946).

The constantly evolving nature of the securities markets and the need for a corresponding flexibility in the law has also influenced the Court's application of Section 10(b) in private civil actions. In *Basic Inc. v. Levinson*, the Court adopted a flexible approach to the element of reliance, allowing it to be presumed where a fraud has affected the market price upon which buyers and sellers rely. 485 U.S. 224, 247. The Court stated: "The modern securities markets, literally involving millions of shares changing hands daily, differ from the face-to-face transactions contemplated by early fraud cases, and our understanding of Rule 10b-5's reliance requirement must encompass these differences." *Id.* at 243-44. In the words of the House Report:

> As a complex society so diffuses and differentiates the financial interests of the ordinary citizen that he has to trust others and cannot personally watch the managers of all his interests . . . it becomes a condition of the very stability of that society that its rules of law and of business practice recognize and protect that ordinary citizen's dependent position.

See Prentice, 75 N.C. L. Rev. at 715-16 (quoting H. Rep. No. 73-1383, at 5 (1934)). The complex securities fraud alleged in this case illustrates the need to apply the law flexibly, as Congress intended.

C. SEC Rule 10b-5, Which Implements Section 10(b), Covers a Wide Range of Acts, Practices, and Schemes in Addition to Untrue Statements and Omissions

The interpretation of the regulatory agency charged with implementing Section 10(b) supports a broad reading of the statutory language. The SEC adopted Rule 10b-5 in accor-

dance with the Congressional directive set forth in Section 10(b). While subsection (b) of the Rule focuses exclusively on "untrue statements" and "omissions" of material fact, the other two subsections address much broader conduct, making it unlawful "to employ any device, scheme, or artifice to defraud," 17 C.F.R. § 240.10b-5(a), or "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit," 17 C.F.R. § 240.10b-5(c). Subsections (a) and (c)—also promulgated in accordance with Section 10(b)—address fundamentally broader types of fraud than the more narrowly written provisions of subsection (b) dealing with misrepresentations and omissions. It is true that the Rule cannot be read to cover more than what Congress intended to reach in Section 10(b) of the Exchange Act, because the SEC's rule making authority was circumscribed by the ambit of the statutory provision it was interpreting. *See Ernst & Ernst*, 425 U.S. at 213. However, the very broad language that Congress used to frame Section 10(b) left ample room for all of the unlawful activities enumerated in subsections (a) through (c) of Rule 10b-5. The SEC's Rule was therefore a reasonable and appropriate explication of the intended scope of the statute and as such, it deserves deference. *See Chevron, U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837, 843-44 (1984).

D. The Decisions of this Court Support the Application of Section 10(b) to Deceptive Conduct Other than Misrepresentations and Omissions

The decisions of this Court support a finding that the phrase "deceptive devices" as it appears in Section 10(b) includes fraudulent acts, as well as misrepresentations and omissions. For example, in *SEC v. Zandford*, 535 U.S. 813 (2002), a client opened an investment account with a broker, for himself and his mentally retarded daughter. *Id.* at 815. Over a two year period, the broker engaged in a pattern of

selling the securities in the account and converting the proceeds for his own use. *Id.* at 815, 820. The focus of the Court's opinion was that the fraud occurred "in connection with the purchase or sale of [a] security," but the Court also held that the combined actions of selling the securities and converting the proceeds constituted a deceptive device under Section 10(b) and Rule 10b-5. The Court noted that the scheme was not authorized or disclosed to the client, but the Court viewed the conduct itself as sufficient to trigger application of Section 10(b) and the Rule: "Indeed, each time respondent 'exercised his power of disposition for his own benefit,' that conduct, 'without more,' was a fraud." *Id.* at 821 (citation omitted).

The Court in *Zandford* also dismissed the argument that the sale of securities and the conversion of funds were independent events. The Court found that the two elements of the scheme were sufficiently linked to support application of Section 10(b) because the sales were effected for the ultimate purpose of converting the proceeds. *Id.* at 820. Similarly in this case, the Respondents engaged in deceptive business transactions for the ultimate purpose of creating fictitious revenues on Charter's books and shoring up Charter's stock price. Under the reasoning in *Zandford*, such deceptive devices fall within the scope of Section 10(b).

In *Superintendent of Insurance v. State of New York*, 404 U.S. 6 (1971), the Court held that Section 10(b) and Rule 10b-5 were applicable to an elaborate scheme in which the defendants sold $5,000,000 worth of securities held by an insurance company, misappropriated the proceeds, and concealed the fraud in the company's books and records. The Court stated that the company "was injured as an investor through a deceptive device which deprived it of any compensation for the sale of its valuable block of securities." *Id.* at 10. Further emphasizing that the scheme was implemented largely through a series of fraudulent acts, not just misrep-

resentations, the Court observed: "The crux of the present case is that Manhattan suffered an injury as a result of deceptive practices touching its sale of securities as an investor." *Id.* at 12-13. The Court was unconcerned that the "fraud was perpetrated by an officer of the corporation and his *outside collaborators*," *id.* at 10 (emphasis added), because Section 10(b) "bans the use of any deceptive device in the 'sale' of any security by 'any person,'" *id.*[2]

This Court's decision in *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983), also supports an interpretation of Section 10(b) that extends it to deceptive acts other than misrepresentations and omissions. In *Herman*, the Court held that a private action lies under Section 10(b) notwithstanding the availability of a remedy under Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k, which prohibits false or misleading information in registration statements. *Id.* at 387. The Court observed that although Section 10(b) and Section 11 may overlap to some degree, they largely address different types of wrongdoing. *Id.* at 382. The Court emphasized that Section 11 could be invoked only against certain parties and only for fraud in registration statements. *Id.* The Court

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[2] The *Superintendent* case, coupled with the broad wording of Section 10(b), disposes of the lower court's suggestion that outside business partners engaged in "arms-length" transactions with issuers cannot be held primarily liable under the statute. *See In re Charter Communications, Inc.*, 443 F. 3d at 991, 992. Section 10(b) covers "any person" using deceptive devices, and the Exchange Act defines the term "person" expansively. *See* 15 U.S.C. 78c(a)(9). It does not limit liability to corporate insiders or professional consultants that have special duties to the company. Even this Court's decision in *Central Bank* recognized the potential liability of outside entities under Section 10(b). It cautioned that the elimination of aiding and abetting liability did not insulate all secondary actors from primary liability under Section 10(b), and noted that "any person or entity" may be liable, provided all the requirements of the statute and the Rule are met. *Central Bank of Denver, N.A.*, 511 U.S. at 191. The Court cited lawyers, accountants, and banks as examples, but not as an exhaustive enumeration of potentially liable secondary actors. *Id.*

explained that Section 10(b) was, "[i]n contrast," a "catchall" antifraud provision, under which "action can be brought by a purchaser or seller of '*any* security' against '*any* person' who has used '*any* manipulative or deceptive device or contrivance' in connection with the purchase or sale of a security." *Id.* at 382 (emphasis in original) (citations omitted).

The Court further explained that limiting the scope of Section 10(b) would immunize any parties—such as corporate officers, lawyers, and accountants—who did not prepare or certify the registration statements but who nevertheless may have engaged in "*fraudulent conduct* while participating in the registration statement." *Id.* at 387 n.22 (emphasis added). In the Court's view, such a result would conflict with the plainly broad language of Section 10(b), and with the rule that securities laws combating fraud should be construed broadly to achieve their remedial purposes. *Id.* at 387-88. In keeping with the decision in *Herman* and Congress's legislative intent, this Court should not immunize parties such as the Respondents, who may not have issued Charter's false financial reports, but who nevertheless participated in the development of those reports through fraudulent conduct.

Some lower federal courts have endorsed the application of Section 10(b) to deceptive conduct as well as misrepresentations and omissions. In *Simpson v. AOL Time Warner, Inc.*, 452 F. 3d 1040 (9th Cir. 2006), the investors alleged that an internet-based real estate company engaged in complex "barter" or "round-trip" transactions with its business clients for the purpose of inflating its revenues. *Id.* at 1043. The Ninth Circuit Court of Appeals articulated the following test for determining whether a defendant may be held liable as a primary violator of Section 10(b): "If a defendant's conduct or role in an illegitimate transaction has the principal purpose and effect of creating a false appearance of fact in the furtherance of a scheme to defraud, then the defendant is using or employing a deceptive device within the meaning of

§ 10(b)." *Id.* at 1050. The court explained that in contrast, "participation in a legitimate transaction, which does not have a deceptive purpose or effect, would not allow for a primary violation, even if the defendant knew or intended that another party would manipulate the transaction to effectuate a fraud." *Id.*

The court emphasized the importance of examining "the deceptive nature of the defendant's own conduct" as a means of differentiating primary violators from mere aiders and abetters, who cannot be found liable under Section 10(b). *Id.* at 1049. The court ultimately dismissed the complaint, with leave to seek amendment, because the allegations failed adequately to aver that the business client's transactions were illegitimate or had created false appearance of fact. *Id.* at 1052-53. However, the court's analysis nevertheless demonstrated that applying Section 10(b) to *deceptive conduct* is at least one principled way of attaching primary liability to those who participate in a fraudulent scheme, while at the same time respecting this Court's prohibition against aiding and abetting liability under *Central Bank*. *See also In re Lernout & Hauspie Sec. Litig.*, 236 F. Supp. 2d 161, 173 (D. Mass. 2003) (denying a motion to dismiss for outside business partners who devised sham corporate entities to hide expenses and overstate profits).[3]

In this case, of course, the Respondents' transactions with Charter were not legitimate and they undoubtedly created a false appearance: that the surcharge for each cable box was a

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[3] The court in *Simpson* also correctly held that the required element of reliance is present in deceptive conduct cases "if the introduction of misleading statements into the securities market was the intended end result of a scheme to misrepresent revenue." 452 F. 3d at 1051. In this case, the introduction of false revenue reports into the marketplace was the intended result of the Respondents' scheme, so the element of reliance is present.

capital expense, and that the return of the surcharge to Charter in the guise of advertising fees was genuine revenue. Accordingly, the Respondents used deceptive devices within the meaning of Section 10(b). *But see Regents of the Univ. of Calif. v. Credit Suisse First Boston (USA), Inc.*, 482 F. 3d 372, 388 (5th Cir. 2007) (disagreeing with the Ninth Circuit's approach in *Simpson* and holding that deception within the meaning of Section 10(b) is limited to a misstatement or a failure to disclose by one who has a duty to disclose).

The lower court in this case relied upon *Central Bank* and *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977), as the basis for its narrow reading of Section 10(b), but in neither of those cases did this Court restrict the application of Section 10(b) to misstatements and omissions. In *Central Bank*, the Court held that the text of Section 10(b) "does not itself reach those who aid and abet a § 10(b) violation." *See* 511 U.S. at 177. In dicta, the Court paraphrased the broad language of Section 10(b) as a prohibition against "the making of a material misstatement (or omission) or the commission of a manipulative act." *Id.* at 177. This isolated observation was not an element of the Court's holding, and it was contradicted by other language in the opinion more accurately characterizing Section 10(b) in terms of "manipulative or deceptive acts." *Id.* at 177-178.

Nor does *Santa Fe* stand for the proposition that Section 10(b) is confined to misstatements and omissions. In *Santa Fe*, minority shareholders alleged they had received undervalued stock from majority shareholders during a merger. The majority shareholders had fully complied with the applicable state merger law, and had fully disclosed the terms of the merger, including the share price and the method used for its computation. 430 U.S. at 466, 469. The Court affirmed dismissal of the complaint, holding that a breach of fiduciary duty by itself, without any deception of any kind, did not comprise a violation of 10(b). *Id.* at 475-76. In the words of

the Court, "We thus adhere to the proposition that 'Congress by § 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement.'" *Id.* at 479 (citation omitted). Although the Court ruled that some form of deception is an essential element of a claim under Section 10(b), the Court also quite clearly understood the concept of deception in a broad sense, one that allowed for deceptive conduct as distinct from misstatements and omissions. For example, in rejecting the plaintiffs' contention, the Court observed that "The cases do not support the proposition . . . that a breach of fiduciary duty by majority shareholders, without any *deception, misrepresentation, or nondisclosure,* violates the statute and the Rule." *Id.* at 476 (emphasis added); *see also id.* at 473 ("The language of § 10(b) gives no indication that Congress meant to prohibit any *conduct* not involving manipulation or deception.") (emphasis added).

All of the foregoing authorities confirm that the plain language and the intended scope of Section 10(b) is broad enough to encompass the Respondents' conduct in this case. The sham transactions they entered into with Charter were "deceptive devices" because they created the false impression that Charter was making bona fide capital expenditures and receiving bona fide revenues in its transactions with the Respondents. In fact, the arrangement had no financial significance whatsoever. Moreover, the Respondents engaged in the deceptive scheme for the ultimate purpose of artificially inflating the market price of Charter's stock, to the detriment of public shareholders. The allegations against the Respondents in this case therefore describe the use of "deceptive devices" to commit securities fraud, in violation of Section 10(b).[4]

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[4] In this case, although the Respondents did not engage in wash sales on an exchange, they did enter into what can certainly be described as "wash" business transactions that had the specific purpose and effect of generating fictitious revenue reports that in turn artificially supported the market price of Charter's shares. *See In re Charter Communications, Inc.,*

II. THE NEED TO PROTECT INVESTORS, BOTH IN THIS CASE AND MORE GENERALLY, SUPPORTS REVERSAL OF THE LOWER COURT'S NARROW INTERPRETATION OF SECTION 10(B)

The lower court based its decision in part on considerations of public policy. The court asserted that imposing liability on the Respondents for deceptive conduct would "introduce potentially far-reaching duties and uncertainties for those engaged in day-to-day business dealings," a policy decision that the court viewed as a matter best left to Congress. *In re Charter Communications, Inc.*, 443 F. 3d at 992-93. The lower court's concerns were unfounded. Applying Section 10(b) to the type of deceptive business deals that the Respondents entered with Charter will impose no duties or uncertainties, other than those that arise from the universal and entirely fitting obligation to refrain from using deceptive devices in schemes to commit securities fraud. Even more important is the lower court's failure to consider *any* of the investor protection policies underlying the securities acts. Those interests justify a broad reading of Section 10(b), not a restrictive interpretation that immunizes participants in a securities fraud.

A. Section 10(b) Is to Be Applied Broadly and Flexibly to Achieve its Objectives

Congress passed the Exchange Act in 1934 as part of an aggressive legislative response to extensive fraud and abuse in the securities markets. The overriding purpose of the

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Sec. Litig, No. MDL 1506, 4:02-SV-1186 CAS, WL 3826761, at *3 (E.D. Mo. Oct. 12, 2004) ("the price increases paid by Charter and 'advertising payments' made by the vendors constituted 'wash' transactions with no economic significance"). The Respondents were full and witting partners in these deceptive transactions and were therefore primary actors in the fraudulent scheme.

statute is to protect investors, and since 1934, this Court has declared again and again that the federal securities laws should be interpreted broadly and flexibly to achieve that remedial purpose. *See generally SEC v. Zandford*, 535 U.S. 813, 819 (2002). Applying this rule of statutory construction in the securities field, the Court has expansively interpreted many facets of Section 10(b): the misconduct that it prohibits, the securities that trigger its application, and the elements of a violation. *See SEC v. Zandford*, 535 U.S. 813 (applying Section 10(b) to sale of client's securities and conversion of proceeds); *Basic Inc. v. Levinson*, 485 U.S. 224 (1988) (rejecting narrow interpretation of materiality with respect to merger negotiations and recognizing a presumption of reliance in cases involving fraud on the market); *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) (broadly defining investment contracts as securities).

B. Congress and the Courts Regard Private Actions Under Section 10(b) as an Especially Important Mechanism for Advancing the Goal of Investor Protection

In these and other decisions, the Court has recognized a strong Congressional policy favoring private actions as a means of achieving the investor protection goals underlying the securities laws. Private actions afford victims of fraud the best and often only hope of recovering their losses—something government enforcement actions are ill-equipped to do on a large scale. Private actions are also an essential deterrent because governmental enforcement program simply cannot, by themselves, inspire compliance with the law. *See generally Pinter v. Dahl*, 486 U.S. 622, 633 (1988) (recognizing the "congressional policy favoring private suits as an important mode of enforcing federal securities statutes"); *Basic Inc. v. Levinson*, 485 U.S. 224, 245 (1988) (noting that presumption of reliance facilitates Rule 10b-5 litigation and therefore supports the congressional policy embodied in the

1934 Act); *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) (denying application of *in pari delicto* defense and observing that "private actions provide 'a most effective weapon in the enforcement' of the securities laws") (citations omitted).

In some cases, the Court has recognized limits on the application of these policies and has declined to adopt a broad interpretation of the securities laws. Where for example, the text of a statute simply does not permit a broad interpretation, the Court has subordinated the policy of investor protection to the text of the law as written. This was the principal rationale for the Court's unwillingness to recognize aiding and abetting liability in *Central Bank*. *See* 511 U.S. at 173, 177 (holding that "the text of the statute controls our decision" and adding that the issue "is not whether imposing private civil liability on aiders and abettors is good policy but whether aiding and abetting is covered by the statute").[5] Similarly, where Congress has deliberately tempered private rights of action through amendments to the securities laws, as it did in the Private Securities Litigation Reform Act of 1995 ("PSLRA"), the Court has respected those limits as well. *See Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 346 (2005) (PSLRA makes clear Congress's intent to permit recovery in private action only where plaintiffs adequately allege causation and loss).

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[5] In *Central Bank*, the Court actually did consider policy implications. It speculated that uncertainty surrounding the scope of aiding and abetting liability might cause legitimate service providers in the securities industry to fall victim to strike suits and to respond by either withholding their services or passing increased costs on to clients and shareholders. *See* 511 U.S. at 189. These concerns are not relevant here because little uncertainty surrounds the use of deception as the test for primary liability. Moreover, shortly after *Central Bank*, Congress addressed the problem of strike suits in the Private Securities Litigation Reform Act of 1995.

No such statutory limitations apply in this case, however. The wording of Section 10(b) poses no obstacle to the theory of liability advanced by the Petitioner in this case. To the contrary, the broad phrasing of Section 10(b) easily accommodates the Respondents' deceptive acts. In PSLRA, Congress instituted heightened pleading requirements, limits on discovery, and other measures aimed at inhibiting abusive strike suits, but it chose *not* to restrict the nature of the "manipulative or deceptive" devices constituting fraud under Section 10(b), nor did it limit the category of "persons" subject to its antifraud provision.[6] *See* 15 U.S.C. § 78u-4. In short, neither the securities laws nor the decisions of this Court can justify a narrow interpretation of Section 10(b) in this case. The Court therefore should give full sway to the dual goals of deterring securities fraud and allowing investors to recover their losses.

C. Allowing the Petitioner's Claims to Proceed Will Further the Deterrent and Remedial Goals of the Exchange Act

Applying Section 10(b) to the type of deceptive conduct at issue in this case will serve these important policies. A holding that views the Respondents' conduct as falling within the scope of Section 10(b) will help deter similar violations by others who are tempted to participate in fraudulent schemes. We are in an era when companies feverishly strive to bolster

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[6] In PSLRA, Congress felt compelled to address the problem of abusive lawsuits, but it also recognized, and sought to preserve, the beneficial role of private actions in combating securities fraud: "Private securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action." *See* H.R. CONF. REP. NO. 104-369 (1995), 1995 WL 709276, at *31. Moreover, Congress recognized that "[s]uch private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers *and others* properly perform their jobs." *Id.* (emphasis added).

publicly announced revenues to sustain their share prices, often by issuing fraudulent financial statements. Companies have partnered not just with their accountants, but also with their investment banks (as in Enron) and their outside vendors (as in this case) in deceptive schemes designed to add credibility and camouflage to those misleading reports. The Court in *Central Bank* acknowledged that in complex securities fraud cases, "there are likely to be multiple violators." *See* 511 U.S. at 191. Allowing investors to seek recourse in such cases will discourage the participation of such consultants and outside business partners in fraudulent schemes.

Reversal of the lower court's narrow interpretation of Section 10(b) will also help investors recover their losses arising from securities fraud. Often the companies directly responsible for the dissemination of false financial statements have collapsed under the weight of the fraud, leaving the other participants in the scheme to answer for the losses that investors have suffered. By exposing all parties responsible for the fraud to civil liability, the law will afford at least some chance of recovery to those who have lost their investments—often their life savings—as a result of the defendants' culpable behavior.

D. Giving Investors Fair Access to the Courts Is Vital Given the Rise in Fraud, the Statutory Limitations that Congress Has Already Placed on Private Actions, and the Lack of Alternative Remedies Under State Law

The need to ensure that investors have meaningful private remedies in federal court has become especially acute as a result of the enactment of PSLRA in 1995. Since then, there has been a marked rise in the incidence of corporate accounting fraud and securities law violations affecting large classes of investors. Congress recognized the seriousness of the problem, and the need for at least a partial legislative

response, when it enacted the Sarbanes-Oxley Act of 2002, 15 U.S.C. §§ 7201-7266. The House Report accompanying the House bill aptly describes the problem of deceptive corporate practices that harm investors:

> The collapse of the Enron Corporation provided irrefutable evidence of serious, systemic problems in our financial reporting system and our capital markets. Far from being an isolated instance, Enron was only the most spectacular example of what has become a common phenomenon—earnings manipulation and deceptive accounting by our largest companies. Before Enron, company after company—Waste Management, Sunbeam, Cendant, W.R. Grace, and many others—were found to have manipulated their accounting to present a picture to investors that did not match reality. As evidenced by the record number of investigations opened by the SEC thus far this year [2002], the problem has only become more acute.

See H.R. REP. NO. 107-414 (2002), 2002 WL 661614, at *47 (Minority Views);[7] *see also, e.g.*, Press Release, No. 2002-179, SEC, NY Attorney General, NASD, NASAA, NYSE and State Regulators Announce Historic Agreement to Reform Investment Practices (SEC, Dec. 20, 2002), *available at* http://www.sec.gov/news/press/2002-179.htm; Press Release, State Investigation Reveals Mutual Fund Fraud (Office of New York Attorney General, Sept. 3, 2003), *available at* http://www.oag.state.ny.us/press/2003/sep/sep03a_03.html.

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[7] For the most part, the laudable provisions of Sarbanes-Oxley are focused on enhancing the regulatory oversight of corporate accounting practices and toughening the penalties for violations of the securities laws. *See, e.g.*, Title I, 15 U.S.C. §§ 7211-19 (establishing an accounting oversight board for public companies); Title VIII, Section 807, 18 U.S.C. § 1348 (increasing criminal penalties for defrauding shareholders of publicly traded companies). It remains for the courts to interpret the securities laws in a manner that affords investors an adequate means of redress for corporate malfeasance.

Those violations have harmed millions of investors nationwide, inflicting huge personal losses. Yet the number of securities fraud class action lawsuits filed in the federal courts has declined, and dismissal rates have increased since PSLRA was enacted. *See generally Hearing on H.R. 5491, Before the House Committee on Financial Services, Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises*, 109th Cong. (2006) (Statement of James D. Cox), *available at* http://www.law.duke.edu/features/pdf/coxtestimony.pdf; Ronald I. Miller, Todd Foster, and Elaine Buckberg, *Recent Trends in Shareholder Class Action Litigation: Beyond the Mega-Settlements, is Stabilization Ahead?* Apr. 2006, *available at* http://www.nera.com/image/BRO_RecentTrends2006_SEC979_PPB-FINAL.pdf (National Economic Research Associates, Inc.).

These conflicting trends have prompted experts in the securities field to surmise that because of PSLRA, "the balance has been tipped too far in favor of preventing claims (some of which would, after discovery, turn out to have merit) rather than protecting investors who have suffered losses. That is, Congress swung the pendulum too far in protecting defendants." Kevin S. Schmelzer, *The Door Slammed Shut Needs to be Reopened: Examining the Pleading Requirements Under the Private Securities Litigation Reform Act*, 78 Temp. L. Rev. 405, 426 (2005); *see also* Joel Seligman, *Rethinking Private Securities Litigation*, 73 U. Cin. L. Rev. 95, 113 (2004) ("the diminution in the effectiveness of private federal securities litigation was one of the several facts that contributed to a reduction in fraud deterrence."). In short, Congress has adopted legislative measures that are more than adequate to protect industry from abusive lawsuits. Where claims of fraud lie well within the statutory boundaries that Congress has set, as they do here, there is no justification for a narrow interpretation of the law that further limits the ability of investors to seek relief.

Federal relief is all the more important when state law does not provide an alternative remedy. This Court has observed that the disadvantages posed by a restrictive interpretation of federal securities law can be "attenuated" where adequate remedies are available under state law. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 738 n.9 (1975) (weighing fact that class action in state court was an alternative remedy); *see also Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 478 (1977) (state cause of action under corporate law was a factor in determining whether to recognize federal cause of action); *J.I. Case Co. v. Borak*, 377 U.S. 426, 434-35 (1964) (noting that if federal jurisdiction is limited and state affords no relief, then the "whole purpose" of the statutory provision might be frustrated). Conversely, where state law does not offer a significant alternative forum for plaintiffs' claims, there is a correspondingly greater justification—and need—for the federal courts to afford relief.

In this case, state law offers limited recourse for investors in the Petitioner's position. Congress has expressly limited the use of class action suits seeking recovery for securities fraud under state law. In 1998, Congress enacted the Securities Litigation Uniform Standards Act ("SLUSA") to address the concern that "securities class action lawsuits [had] shifted from Federal to state courts" as a means of circumventing PSLRA. *See* Notes, 15 U.S.C.A. § 78a (excerpt from Congressional findings in Pub. L. 105-353, § 2, Nov. 3, 1998). With certain exceptions, SLUSA provides that no class action based upon state law may be maintained in any state court on behalf of more than 50 class members. *See* 15 U.S.C. § 77p(b). Moreover, state courts generally have not recognized the doctrine of fraud-on-the-market in cases seeking relief under state common law, further limiting the state courts as an alternative forum for investors aggrieved by large-scale market manipulation of the sort alleged in this case. *See, e.g., Peil v. Speiser*, 806 F.2d 1154, 1163 (3rd Cir. 1986) (no states have adopted fraud on the market theory);

Kaufman v. i-Stat Corp., 754 A.2d 1188, 1193-94 (N.J. 2000); *Mirkin v. Wasserman*, 858 P.2d 568, 584 (Cal. 1993).

Precisely because of the massive corporate frauds that have surfaced in recent years, some courts have recognized the need to re-evaluate barriers to civil actions alleging securities fraud. The California Supreme Court, for example, has cited the troubling increase in corporate fraud as a reason to recalibrate the balance between the interests of investors and the interests of corporations, in favor of providing greater judicial recourse to victims of fraud:

> When Congress enacted the Private Securities Litigation Reform Act of 1995 and the Uniform Standards Act of 1998, it was almost entirely concerned with preventing nonmeritorious suits. (Stout, supra, 38 Ariz. L. Rev. 711). But events since 1998 have changed the perspective. The last few years have seen repeated reports of false financial statements and accounting fraud, demonstrating that many charges of corporate fraud were neither speculative nor attempts to extort settlement money, but were based on actual misconduct. "To open the newspaper today is to receive a daily dose of scandal, from Adelphia to Enron and beyond. Sadly, each of us knows that these newly publicized instances of accounting-related securities fraud are no longer out of the ordinary, save perhaps in scale alone." (Schulman, et al., The Sarbanes-Oxley Act: The Impact on Civil Litigation under the Federal Securities Laws from the Plaintiff's Perspective (2002 ALI-ABA Cont. Legal Ed.) p.1.) The victims of the reported frauds, moreover, are often persons who were induced to hold corporate stock by rosy but false financial reports, while others who knew the true state of affairs exercised stock options and sold at inflated prices. (See Purcell, The Enron Bankruptcy and Employer Stock in Retirement Plans, Congressional Research Service (Mar. 11, 2002).) Eliminating barriers that deny redress to actual victims

> of fraud now assumes an importance equal to that of deterring nonmeritorious suits.

See Small v. Fritz Companies, Inc., 65 P. 3d 1255, 1263-64 (Cal. 2003).

As financial crimes abound and as alternative forums for aggrieved investors remain limited, it is especially important that the federal courts interpret federal law in a way that, to the extent possible, affords meaningful remedies to victims of securities fraud. Reversing the lower court's decision will help accomplish this objective.

CONCLUSION

For the reasons set forth above, the decision of the United States Court of Appeals for the Eighth Circuit should be reversed.

Respectfully submitted,

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